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SUBJECT: ECONOMIC FORECAST FOR ITALY 2002-2003: JUNE  
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[¶](#)18. THE PUBLIC DEFICIT INCREASED TO 41.4 BILLION EUROS THROUGH MAY 2002, UP 6.9 PERCENT OR 2.7 BILLION EUROS OVER THE CORRESPONDING PERIOD IN 2001. THE GOI MAINTAINS THAT IT WILL BRING DOWN THE DEFICIT TO .5 PERCENT OF GDP IN 2002. FORECASTERS BELIEVE THIS PREDICTION IS TOO OPTIMISTIC. THE MACRO ASSUMPTIONS OF THE GOI BUDGET STRATEGY, THOUGH REVISED DOWNWARD, ARE STILL TOO OPTIMISTIC AND THE PUBLIC DEFICIT IS GROWING FASTER THEN EXPECTED. REASONS INCLUDE LOWER THAN EXPECTED REVENUES FROM SALES OF GOVERNMENT-OWNED REAL ESTATE, AND THE LIMITED NUMBER OF COMPANIES OPERATING IN THE UNDERGROUND THAT HAVE BECOME LEGAL, TAX PAYING ENTITIES. FEW UNDERGROUND COMPANIES HAVE TAKEN ADVANTAGE OF A ONE-TIME PARTIAL TAX FORGIVENESS. THE GOI HAS RECEIVED ONLY FOUR MILLION EUROS IN TAXES FROM COMPANIES THAT CHANGED THEIR STATUS, FAR LESS THAN THE ONE BILLION EUROS EXPECTED.

[¶](#)19. A ONE-TIME TAX AMNESTY FOR THE REPATRIATION OF  
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CAPITAL SEEMS TO HAVE BEEN SUCCESSFUL. DURING THE NINE-MONTH PROGRAM, REPATRIATED CAPITAL WAS TAXED AT 2.5 PERCENT. THROUGH APRIL, AN ESTIMATED 32.5 BILLION EUROS WERE REPATRIATED, GENERATING TAX REVENUES OF 810 MILLION EUROS.

[¶](#)20. TO OFFSET IN PART THE HIGHER THAN EXPECTED PUBLIC DEFICIT, THE GOI PRESENTED TO PARLIAMENT IN FEBRUARY A DEFICIT CONTROL PACKAGE AIMED AT RECOVERING 675 MILLION EUROS THIS YEAR AND 2.5 BILLION EUROS NEXT YEAR, RECENTLY CONVERTED INTO LAW. MEASURES INCLUDE:

[¶](#)A. A FIVE-PERCENT CUT IN GOI PAYMENTS TO PHARMACEUTICAL COMPANIES. FINANCE MINISTER TREMONTI EXPECTS THIS MEASURE TO PRODUCE 500 MILLION EUROS IN SAVINGS. PHARMACEUTICAL COMPANIES, INCLUDING U.S.-OWNED FIRMS, HAVE OBJECTED STRONGLY TO THIS PRICE CUT;  
[¶](#)B. THE DEADLINE FOR MANY PERSONAL AND CORPORATE TAX PAYMENTS WAS MOVED UP FROM JULY 31 TO JUNE 20;  
[¶](#)C. AREFORM OF CASSA DEPOSITI AND PRESTITI, TWO SAVINGS AND LOAN FUNDS, THROUGH THE CREATION OF TWO COMPANIES;  
D1. PATRIMONIO DELLO STATO S.P.A., WHICH OWNS STATE-OWNED REAL ESTATE. THE SALE OF SUCH REAL ESTATE IS EXPECTED TO EVENTUALLY GENERATE INCOME EQUAL TO FIVE PERCENT OF GDP;  
D2. INFRASTRUTTURE S.P.A., WHICH IS INTENDED TO FINANCE INFRASTRUCTURE AND PUBLIC WORK PROJECTS THROUGH THE ISSUANCE OF BONDS;  
[¶](#)E. THE ABOLITION OF TAX INCENTIVES FOR BANK MERGERS.

[¶](#)21. FINANCE MINISTRY OFFICIALS MAINTAIN THAT A PUBLIC  
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DEFICIT EQUAL TO .5 PERCENT OF GDP WILL BE ACHIEVABLE IF GDP GROWTH IS 2.3 PERCENT. IF GDP GROWTH IS 1.5 PERCENT, THE PUBLIC DEFICIT IS LIKELY TO BE .9 PERCENT OF GDP. IN CONTRAST TO GOVERNMENT EXPECTATIONS, WE ESTIMATE THAT THE PUBLIC DEFICIT WILL BE 1.5 PERCENT IN 2002 AND DECLINE TO ONE PERCENT IN 2003. THIS IS ONE PERCENTAGE POINT ABOVE STABILITY PACT TARGETS FOR 2002 AND 2003. ONLY IF A SUBSTANTIAL DEFICIT REDUCTION PACKAGE IS IMPLEMENTED WILL THE GOI BE NEAR A ZERO PERCENT PUBLIC DEFICIT, AS REQUIRED BY THE EU STABILITY PACT.

[¶](#)22. AT THE CENTRAL BANKS ANNUAL MEETING, BANK OF ITALY GOVERNOR ANTONIO FAZIO CALLED FOR A SUPPLEMENTARY BUDGET PACKAGE TO BRING PUBLIC FINANCES IN LINE WITH THE STABILITY PACT. FINANCE MINISTER TREMONTI SAID THERE WOULD BE NO CORRECTIVE BUDGET PACKAGE EVEN IF THE PUBLIC DEFICIT CONTINUED TO CLIMB.

STRUCTURAL REFORMS

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123. CENTRAL BANK GOVERNOR FAZIO ALSO URGED THE GOI TO SPEED UP STRUCTURAL LABOR, PENSION AND TAX REFORMS. OPPOSITION FROM TRADE UNIONS, WHICH HAVE PLAYED A KEY ROLE IN SOCIAL AND ECONOMIC POLICY-MAKING, HAS STALLED PROGRESS ON KEY LABOR AND ECONOMIC REFORMS. ALTHOUGH HE ENJOYS A SECURE MAJORITY IN PARLIAMENT, PM BERLUSCONI SEEKS TO BUILD CONSENSUS RATHER THAN IMPOSE MAJOR CHANGES. SINCE THIS PROCESS WILL TAKE TIME, THE PROSPECT FOR SIGNIFICANT REFORMS IS NOT ROSY. SEE REFTEL A FOR BACKGROUND ON THESE STRUCTURAL REFORMS AND THE PROSPECT FOR CHANGE. ONCE NEGOTIATIONS RESUME, WE EXPECT SOME LABOR REFORM MEASURES WILL BE ENACTED THIS YEAR, BUT THEY WILL HAVE ONLY A MINOR EFFECT ON THE ECONOMIC CLIMATE, AT LEAST IN THE SHORT AND MEDIUM TERM.

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PENSION FUNDS.

125. THE ROUNDING UP OF PRICES FOLLOWING THE EURO CHANGEOVER AND HIGHER PRICES FOR AGRICULTURAL PRODUCTS, WHICH RESULTED FROM AN UNUSUALLY COLD WINTER, PUSHED UP INFLATION IN THE FIRST PART OF THIS YEAR. EXCLUDING THE PRELIMINARY DATA FOR MAY, RETAIL INFLATION WAS 2.4 PERCENT HIGHER IN THE FIRST FOUR MONTHS OF 2002 THAN DURING THE CORRESPONDING PERIOD IN 2001.

127. ACCORDING TO A RECENT POLL CARRIED OUT BY THE LEADING CONSUMER ASSOCIATION, CODACONS, SEVENTY PERCENT OF ITALIANS SURVEYED WOULD LIKE THE LIRA TO RETURN; EIGHTY PERCENT ARE CONVINCED THEY SPEND MORE IN EUROS THAN THEY DID IN LIRA PER MONTH. NINETY PERCENT OF THOSE SURVEYED SAID THEY CALCULATE PRICES AND PUT ACCOUNTS IN LIRA AS WELL AS EUROS. THIRTY PERCENT SAID THAT THEY HAVE PROBLEMS WITH THE NEW BANKNOTES, AND OFTEN CONFUSE THE ONE AND TWO EURO CENT

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28. AFTER THE 2.4-2.5 PERCENT PEAKS IN YEAR-TO-YEAR INFLATION REGISTERED IN THE FIRST FOUR MONTHS OF 2002, THE CPI IS EXPECTED TO SLOW, PRODUCING A 2.4 PERCENT AVERAGE INFLATION RATE THIS YEAR. WE EXPECT INFLATION TO DECLINE TO TWO PERCENT IN 2003.

129. THE BERLUSCONI GOVERNMENT HAS PROPOSED THE SALE OF STATE-OWNED ENTITIES AND OF GOVERNMENT-OWNED SHARES OF MAJOR COMPANIES, INCLUDING ENERGY COMPANY ENEL AND ENTE TABACCI ITALIANI (ETI - ITALY'S NATIONAL TOBACCO COMPANY.) UNCERTAIN MARKET CONDITIONS HAVE, HOWEVER,

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DELAYED THE TIMING OF SUCH SALES. WHEN THE MARKET RECOVERS, THE GOVERNMENT HOPES SALES OF GOVERNMENT-OWNED ENTITIES AND SHARES WILL BRING IN 60 BILLION EUROS. THE FIRST GROUP TO BE PRIVATIZED WILL BE THE RESIDUAL STAKE OF TELECOM ITALIA (3.46 PERCENT), THE SALE OF ETI AND 85 PERCENT OF TIRRENA (MARITIME TRANSPORTATION), PLUS THE SALE OF ANOTHER TRANCHE OF ENEL (ELECTRICITY CONGLOMERATE).

## LABOR

130. GOVERNMENT DATA FROM JANUARY 2002 SHOW THE QUARTERLY NATIONAL UNEMPLOYMENT RATE AT 9.2 PERCENT, DOWN FROM 10.2 PERCENT OF JANUARY 2001, WHICH IS THE LOWEST LEVEL SINCE 1992. UNEMPLOYMENT DECREASED ALSO IN ABSOLUTE TERMS BY 7.6 PERCENT FROM 2,379,000 IN JANUARY 2001 TO 2,198,000 IN JANUARY 2002.

31. TRADITIONAL REGIONAL DIFFERENCES REMAIN UNCLASSIFIED

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UNCHANGED, WITH THE SOUTHERN THIRD OF THE COUNTRY  
HAVING AN 18.8 PERCENT (20.3 PERCENT IN JANUARY  
2001) UNEMPLOYMENT RATE COMPARED TO 3.9 PERCENT IN  
THE NORTHERN THIRD (4.2 PERCENT IN JANUARY 2001) AND  
SEVEN PERCENT IN CENTRAL ITALY (EIGHT PERCENT IN  
JANUARY 2001). EMPLOYMENT INCREASED BY 371,000  
PEOPLE FROM 21,273,000 IN JANUARY 2001 TO 21,644,000  
IN JANUARY 2002. THIS IS THE RESULT OF AN INCREASE  
OF 99,000 WORKERS IN THE NORTH-EAST (UP 2.2 PERCENT  
FROM JANUARY 2001) AND OF 73,000 WORKERS IN THE  
NORTH WEST (UP 1.2 PERCENT FROM JANUARY 2001),  
COMBINED WITH AN INCREASE OF 85,000 WORKERS IN THE  
CENTER (UP TWO PERCENT FROM JANUARY 2001) AND  
114,000 WORKERS IN THE SOUTH (UP 1.9 PERCENT).

132. ONE-FIFTH OF TOTAL EMPLOYMENT INVOLVES TEMPORARY OR PART-TIME JOBS, PRIMARILY IN THE SERVICES SECTOR.

133. WE EXPECT UNEMPLOYMENT TO FALL FURTHER, TO BELOW NINE PERCENT OVER THE FORECAST PERIOD.

COMMENT

134. FOR ITALYS GDP TO REBOUND MORE VIGOROUSLY AND SUPPORT EXPORT GROWTH, THE GOI NEEDS TO MOVE AHEAD WITH CUTS IN PUBLIC SPENDING, ACCELERATE ITS PRIVATIZATION AND INFRASTRUCTURE PROGRAMS, AND ENACT KEY REFORMS IN THE PENSION, LABOR AND TAX SYSTEMS QUICKLY.

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135. ITALY, ALONG WITH THE REST OF THE EU, WILL BENEFIT FROM A MODERATE ECONOMIC RECOVERY EXPECTED OVER THE FORECAST PERIOD. THE SOONER A GLOBAL RECOVERY BEGINS, THE HEALTHIER THE EXPORT-DRIVEN ITALIAN ECONOMY WILL BE. WE SHARE LEADING THINK TANKERS VIEW, INCLUDING THAT OF THE BANK OF ITALY, THAT THE GOIS OFFICIAL FORECASTS FOR GDP GROWTH, THE BUDGET DEFICIT AND TAX REVENUES ARE OVERLY OPTIMISTIC. THE GOI DESERVES PRAISE FOR BEGINNING TO TACKLE THE THORNY ISSUES OF PENSION AND LABOR MARKET REFORM. EVEN IF THESE REFORMS ARE ADOPTED, HOWEVER, THEIR POSITIVE EFFECTS ON THE ECONOMY WILL BE FELT ONLY BEGINNING IN 2003 OR LATER.

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	EAP-00	EUR-00	EXIM-01	E-00	UTED-00	FOE-00	VC-00
	FRB-00	IPS-01	H-01	TEDE-00	INR-00	ITC-01	AC-01
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ACCOUNTS BASIS (TRILLIONS OF LIRE)

HISTORICAL SERIES-REAL AND NOMINAL GDP 2000-2003

### SUMMARY TABLE

SUMMARY TABLE		2001		2002		2003	
		ANN. AVG	4TH/ 4TH/	(F) ANN. AVG	4TH/ 4TH/	(F) ANN. AVG	4TH/ 4TH/
GDP		1.8	0.6	1.3	2.8	2.4	2.5
DOMESTIC DEMAND		1.6	0.3	1.4	3.0	2.4	2.5
INFLATION		2.8	2.4	2.4	2.4	2.0	2.1
	2.8 2.4	2.4	2.4	2.0	2.1		
PRODUCER PRICES		1.9	-1.0	0.1	1.9	2.3	1.8
UNEMPLOYMENT RATE		9.5	9.3	9.2	9.1	8.9	8.8

EXPENDITURES	47.2	46.8	47.1
REVENUES	45.8	45.4	46.1
DEFICIT	-1.4	-1.5	-1.0
PUBLIC			
DEBT	109.4	105.0	102.0
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TRADE ACCOUNT			
USD BILL.	15.9	15.4	20.4
PCT OF GDP	1.5	1.4	1.6

CURRENT ACCOUNT			
USD BILL.	0.2	3.6	8.6
PCT OF GDP	0.0	0.3	0.7

AVG EXCHANGE RATE			
USD/EURO	0.89	0.90	0.97
EURO/USD	1.12	1.11	1.03

## I. NATIONAL ACCOUNTS, INDUSTRIAL PRODUCTION, PRICES AND UNEMPLOYMENT



	1999	2000	2001	2002(F)	2003(F)
YEAR	11.4	10.6	9.5	9.2	8.9
4TH QTR	11.1	10.0	9.3	9.1	8.8



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	2000	2001	2002	2003
EXPORT VOLUME	11.1	0.1	1.5	(F)
UNIT VALUE	6.0	3.3	0.5	5.7
IMPORT VOLUME	10.0	-0.3	1.8	2.3
UNIT VALUE	14.2	0.5	0.6	6.1
TERMS OF TRADE	-7.2	-2.9	-0.1	1.0
2.7				1.3

	2000	2001	2002	2003
			(F)	(F)
TRADE BALANCE	10.4	17.8	17.1	21.1
EXPORTS FOB	260.9	270.9	276.2	298.5

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II.C. CURRENT ACCOUNT (USD BILLION)

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INCOMES		-12.1	-10.4	-9.4	-9.4
NET TRANSFERS		-4.4	-6.0	-3.0	-3.4
CURRENT ACCOUNT		-5.8	-0.2	3.6	8.6
PCT OF GDP		-0.5%	0.0%	0.3%	0.7%

## MEASURES OF FISCAL BALANCES, 2000-2003

	REVENUES	EXPENSES	BALANCE BALANCE	PRIMARY
2000	520,828	540,891	-20,063	54,870
PCT OF GDP	44.7	46.4	-1.7	4.7
2001	557,203	574,817	-17,614	54,870

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